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Bondholders slam deal

By Marcia Parker

A group of convertible securities investors is threatening to block a $152.5 million friendly takeover of Wherehouse Entertainment Inc. unless convertible investors are guaranteed of reaping the rewards of the merger, not piling up losses.

The group is led by Froley, Revy Investment Co. Inc., a Los Angeles money manager. Like other convertible investors, Froley, Revy, which owns more than $8 million of Wherehouse Entertainment's 6¼% convertible subordinated debentures due 2006, stands to lose money on the Wherehouse deal because the tendering price for the convertibles is almost half the $27.60-per-share conversion price.

The investment management firm might take legal or other action to challenge the merger, according to Thomas Revy, managing director. Executives at Wherehouse and Adler & Shaykin, the private New York investment firm that would take over Wherehouse, declined to comment other than to say through a spokesman they don't believe the convertible debenture holders have a case.

The board of directors of Wherehouse, a specialty retailer of home entertainment and information software, approved a merger agreement with Adler & Shaykin late last month. Under the agreement, WEI Holdings Inc., a company formed by Adler & Shaykin, will acquire Wherehouse for $14 per share in cash. The Adler & Shaykin tender offer expires Jan. 22, although it may be extended.

Wherehouse's board agreed to the Adler & Shaykin offer after rejecting an unwelcomed advance from Shamrock Holdings Inc., which commenced a $12-per-share offer for Wherehouse shares in November.

Until now, major investors in convertible securities — fed up with losing millions of dollars on conversion rights in some takeovers and restructurings — tried to sweet talk issuers and Wall Street underwriters into putting protective clauses in the indentures of new convertible issues guaranteeing convertible investors a fair return on their investments (*Pensions & Investment Age*, July 27).

But they've only succeeded in getting a few issuers and underwriters to include the special wording.

Now some convertible investors are getting more militant. Led by Froley, Revy, the investors are choosing specific takeover battles to air their cases and pushing for a legislative solution that would ensure the kind of rights common stockholders have long enjoyed.

"We hope to catch the attention of the Securities and Exchange Commission," Mr. Revy said of his drive to secure more equitable treatment of convertible investors. "The SEC seems

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Street financing to drop in 1988

By Marcia Parker

NEW YORK — Corporate America's coffers will be brimming over in 1988, bolstered by a $30 billion-plus increase in internal cash flow that will lessen its need to tap external financing sources, Salomon Brothers Inc. predicts.

The investment bank's annual report on the prospects for the financial markets says reduced liquidity requirements are likely to push corporate external financing needs to less than $60 billion — just below the 1987 level.

That forecast has negative implications for already struggling Wall Street firms and the corporate finance wizards who help companies raise money. Even the most venerable Wall Street investment banks have been cutting jobs to reflect the realities of the post-Black Monday market.

Meantime, the sharp erosion of pension surpluses since Black Monday also will affect corporate earnings and balance sheets, and suggests pension plans could be net sellers of stock in 1988, Salomon said.

Private funds are expected to accelerate their net liquidation of stocks to more than $30 billion in 1988 from about $19 billion in 1987.

But Salomon Brothers said that, as has been true for the past few years, the activity on the pension side of the corporation may be overwhelmed by companies' buying stock for their own account via repurchases or acquisitions. Equity retirements will far surpass new equity offerings.

Corporate external financing needs will be relatively low this year for several reasons, the investment bank said.

Gains in the export sector, along with higher rates of inflation and the ongoing benefits of cost-cutting efforts, will boost pre-tax corporate profits, Salomon Brothers said.

Nevertheless, Salomon Brothers looks for a modest pickup in net equity retirements to $60 billion in 1988 from $52 billion in 1987, which will keep debt financing comparatively high. The investment bank anticipates continued lofty levels of mergers and leveraged buy-outs, an increase in repurchase programs and a decline in new stock offerings and conversions.

As the yield curve begins to steepen in the spring, Salomon Brothers expects corporations to further shorten the maturi-

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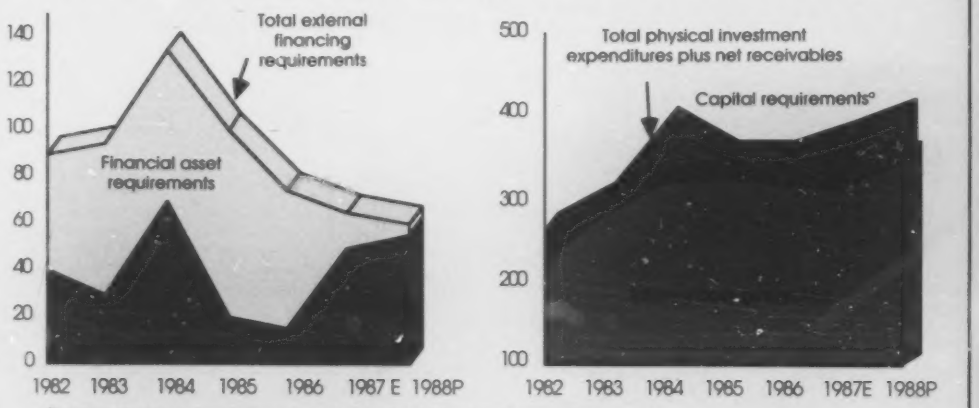
Net financing needs of non-financial business corporations ($ billions)



*Total physical investments plus net receivables less internal cash generation

Source: Salomon Brothers Inc., New York

INSIDE

Currency blues — P. 27

The current foreign exchange market is making it tough on proponents of currency management, a technique used in international investing that experts say can preserve and add value to international portfolios.

Contract hoopla — P. 13

Backers of the U.S. Dollar Index future contract — touted as a great alternative to currency-by-currency hedging — are looking for commitments from tax-exempt investors to make it more popular and push it into orbit.

A $10 billion makeover

California Employees remodeling passive equities

By Chuck Paustian

SACRAMENTO, Calif. — The $44 billion California Public Employees' Retirement System is restructuring about $10 billion to $12 billion of internally managed equity assets, eliminating a $5.5 billion equity index fund and creating 13 separate portfolios.

All of the fund's in-house equity assets will be allocated among six core portfolios, six active portfolios and a South Africa portfolio. All the portfolios will be internally managed.

"It's something we've had in the planning stages for some time," said Greta E. Marshall, investment manager at the retirement system, the nation's second largest. "We delayed implementing it last year because we were converting to a master custodian and we preferred to complete that conversion first."

Wilshire Associates, Santa Monica, Calif., provided data to help with the restructuring. The fund's seven external equity managers, which manage between $4 billion and $5

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LATE NEWS

Hitchman leaving Washington

OLYMPIA, Wash. — John A. Hitchman, executive director of the $13 billion Washington State Investment Board, will resign effective the end of March and join one of the board's equity managers, Los Angeles-based Hotchkis and Wiley.

"I certainly feel satisfied in my present employment," he said. "It's just that I think Hotchkis and Wiley is an excellent firm and there's a lot of opportunity there."

Although his title at Hotchkis and Wiley was not determined, Mr. Hitchman said he will work with the firm's partners in investing the more than $2.4 billion under management. Hotchkis and Wiley runs about $160 million for the Washington investment board.

Officials of the Washington investment board have selected a panel to find a replacement for Mr. Hitchman, but a timetable hasn't been set.

Mitchell Hutchins buys MHIC

NEW YORK — Mitchell Hutchins Asset Management Inc., PaineWebber Inc.'s money management affiliate, has acquired Manufacturers Hanover Investment Corp., an institutional investment management subsidiary of Manufacturers Hanover Corp., for $27 million.

MHIC, which is based in New York, manages about $22 billion of institutional assets and is a leading manager of institutional money. Mitchell Hutchins, also headquartered in New York, manages about $16 billion in assets. It is strong in mutual funds and accounts for high net worth individuals.

"We don't have a large institutional business and this will give us that presence. We wanted to build a major full scale asset management firm," said Cheryl K. Gruetzmacher, managing director of institutional asset management for Mitchell Hutchins.

Manufacturers Hanover said in a statement the investment management subsidiary "had become peripheral to its strategic thrust since there was little linkage between MHIC's domestic business and other units of the parent."

Pope quits AMR to join United

FORT WORTH, Texas — John C. Pope, senior vice president-finance and chief financial officer of AMR Corp., has resigned to become executive vice president-finance and chief financial officer at rival United Airlines, Chicago.

AMR Corp. is the parent company for American Airlines.

An AMR spokesman said most of Mr. Pope's duties will be assumed by Donald J. Carty, now senior vice president-airline planning, who will become senior vice president-finance and planning.

Funds fighting takeover law

WASHINGTON — At least four of the nation's largest pension funds have teamed up with shareholder rights groups to sponsor a media blitz aimed at defeating the anti-takeover bill scheduled for consideration by the Delaware State Assembly this month.

Among the funds joining forces with the Washington-based groups — Institutional Shareholder Services and United Shareholders Association — are the $40 billion California Public

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HIGHLIGHTS

Financial wizardry in '87 — P. 21

Wall Street conjured up some financial magic for clients such as General Electric Credit Corp. (now General Electric Capital Corp.), above, in 1987. *Pensions & Investment Age* takes a look at the best deals pulled from the hats of Street magicians.

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Law may speed stock pull-back

By Nicky Robertshaw

WASHINGTON — Corporations, already shaken by the Oct. 19 market plunge and attempting to adjust to new pension accounting rules, have been given additional strong incentives to pull their pension assets from the stock market by the budget act passed by Congress last month.

The combined effect of new pension rules incorporated in the budget act and the pension accounting rules of the Financial Accounting Standards Board Statement 87 is likely to drive corporations to greater use of bond and hedged strategies.

Title IX of the Omnibus Budget Reconciliation Act of 1987, enacted last month, "will provide simply one more Pavlovian incentive to take a look at the asset-liability ratio," said Eric P. Lofgren, a principal in the New York office of William M. Mercer-Meidinger-Hansen Inc. "I don't think plan sponsors will throw away long-term growth, but they will try to find a compromise between long-term growth and preserving the asset-liability ratio."

"A few years ago you could keep cash flow pretty stable," said Lawrence N. Bader, a vice president at Salomon Brothers Inc., New York. But FASB 87 "changes the stability of expenses by requiring sponsors to discount the liability at market interest rates. Now, with (budget reconciliation), you upset the stability of contributions — at least with plans at the two ends (of the fundedness scale). For moderately well-funded plans, you tighten the boundaries."

"The direction Congress is going, not only with this but with the Tax Reform Act of 1986 and others, is to make more narrow the acceptable range of funding for plans," said Kenneth W. Porter, chief actuary of E.I. du Pont de Nemours & Co., Wilmington, Del. He added this could have a volatile effect on cash flow.

"It seems to me that this new law has more of an effect on funding than on cash flow," agreed Robert E. Angelica, director of pensions and investments, American Telephone & Telegraph Co., New York, who noted he had not yet studied it.

He added the law could cut down on management's ability to build up a cushion against adverse market experience and other future developments "by cutting tighter corners."

Because the new law sets 30-year Treasury bond interest rates as the "moving target" that will cause fluctuation in the asset-liability ratio, pension funds eventually will move more toward fixed-income investments.

Sponsors of underfunded plans particularly are affected because financially troubled companies might not be able to afford the stiffer monetary requirements that would accompany dips in their funding status. Such funds eventually would have to stay away from the more volatile equity markets, Mr. Lofgren said.

Among investment instruments thought to become more popular in light of the recent developments:

- Dollar-duration immunized portfolios, such as that implemented by American Airlines (*Pensions & Investment Age*, March 9). Under this arrangement, a company can cover its pension liabilities by investing less than half of its assets in a bond portfolio of longer duration than the liabilities.
- Hedges against large stock market losses — both existing methods such as portfolio insurance and new devices that might be developed. Mr. Lofgren, who describes himself as a longtime foe of portfolio insurance, sees it as favorable if used wisely. He believes the market crash has thinned the number of users —

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Asset mix is key issue

By Chuck Paustian

Pension fund executives are paying more attention to asset allocation than any other topic, trying to deal with the increased volatility of the financial markets.

An informal survey of investment consulting firms found asset allocation to be the most frequent topic of discussion with their clients.

"The October decline and the November decline have reinforced the importance of having the (asset allocation) structure right," said William F. Brock, director of consulting at Evaluation Associates Inc., Norwalk, Conn.

The Financial Accounting Standards Board Statement 87 and various investment strategies geared toward its implementation also are hot topics, the consultants said.

Sandy Lincoln, managing director of asset planning services for William M. Mercer-Meidinger-Hansen Inc., Deerfield, Ill., noted two reasons for the current emphasis on asset allocation.

"First and probably foremost is the volatility of the markets," Mr. Lincoln said. "People are seeing a tremendous amount of volatility in the stock and bond market both, and people are asking, 'What can we do to protect ourselves?' "

He also said FASB 87, which will require corporations to note the funded status of their pension funds on the balance sheet, has corporate pension executives looking at asset allocation to protect or improve the relationship between assets and liabilities.

"It has focused the plan sponsors on the level where they can make the biggest impact, which is asset allocation," he said.

The goal of the allocation studies, the consultants said, has been to examine how well the asset mix served the pension fund, rather than to analyze the performance of particular asset classes.

"We're really focusing more on this question of the risk of the underlying asset classes and how this will impact asset allocation in the future," said Lawrence E. Davanzo, senior president of Wilshire Associates, Santa Monica, Calif.

"It's more evolutionary in regard to structure as opposed to reactionary as in looking for a quick fix and preparing for the next crisis," said Mr. Brock.

Corporate executives also face the dilemma of trying to maximize investment returns while mitigating fluctuations in pension expense resulting from adjusting the market values of a pension plan's assets and liabilities.

"If anything, the emerging solutions (to this problem) seem to favor bonds," said Ronald J. Surz, a principal of Becker, Burke Associates Inc., Chicago. The idea, he said, is the value of the fixed-income assets will increase or decrease in concert with the plan's liabilities as interest rates change.

Mr. Surz added, however, "Bonds have been getting

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Highs, lows of market is top story

The boom-and-bust stock market of 1987 was the most significant finance story of the year, according to *Pensions & Investment Age* readers.

Predictably, the gyrating market was ranked among the top five stories by almost 78% of the voters.

Readers were asked in the Nov. 30 issue to rank — from 18 choices — the five most important financial news stories of the year. The responses were tabulated by awarding five points to the top-ranked story, four points to the second-ranked one and so forth.

The stock market —which last year marked the fifth anniversary of a bull run, a record high and a record one-day drop — easily swept the vote.

Japanese investment was deemed the second most important story of the year, being named by almost 52% of the respondents.

Last year, Japanese investors poured billions of dollars into the U.S. stock and equity real estate markets, while for the first time, U.S. investment institutions tapped into $16 billion in Japanese assets, through individual efforts and joint ventures with Japanese firms.

The Financial Accounting Standards Board's Statement 87 and corporate strategy "integration" brought increased scrutiny to pension fund assets and liabilities, making the asset/liability issue the third most important story to *P&I Age*'s readers, showing up on 37% of their ballots. (FASB 87 requires pension liabilities to be shown on a corporation's balance sheet.)

Although the growth of the nation's pension surplus did not make it into the the top five stories, the dispute over who is entitled to those surplus assets did, ranking fourth in points

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Modest growth for indexing

By Trudy Ring

Indexing continued to grow, albeit at a modest rate, in the six months ended Nov. 30.

Domestic stock index funds run by 29 major managers had a net gain in assets under management of 5.5% in the period, while domestic bond index funds had a net gain of 1.9%. International stock index funds had a net gain of 4.2%.

The figures are based on the indexed assets of management firms that provided *Pensions & Investment Age* with information for both May 30 and Nov. 30 and reflect adjustment for market gain or loss.

"Net/net, we've seen much more inflow than we have outflow in our index funds," said Carol Zipkin, senior vice president of Alliance Capital Management Corp., New York.

"We've seen more contributions come into our index funds than go out, but nothing dramatic," said Steve Krisik, vice president of Northern Trust Co., Chicago.

Indexers hope to benefit further after plan sponsor committees review their asset allocations and managers' results in the wake of the October stock market decline.

Preliminary statistics from at least one consultant might boost those hopes.

According to unpublished data compiled for clients by Wilshire Associates, Santa Monica, Calif., active equity managers underperformed the stock market during the month of October and the 10 months ended Oct. 31, and value managers failed to add much value in the down market. If fourth-quarter 1987 returns — which for the most part won't be available until the end of this month — reinforce those findings, more sponsors might opt for indexed funds.

"What happens is people typically have a flurry of activity — making reports, meeting with committees," said Bill Fouse, chairman of Mellon Capital Management Corp., San Francisco. That process takes a few months, he said. "But the repercussions will start to be seen as early as March."

Included among the 29 managers providing information for both Nov. 30 and May 30 was $98.3 billion in domestic stock index funds, $40.7 billion in domestic bond index funds and $5.7 billion in international stock index funds as of Nov. 30.

As of May 30, those managers had $115.6 billion in stock index funds, $38.9 billion in bond index funds and $6.2 billion in international index funds. Those numbers were then adjusted by major market indexes for comparison with the Nov. 30 figures.

During the six months, the Standard & Poor's 500 stock index declined 19.4%, the Shearson Lehman Government/Corporate bond index gained 2.6% and the Morgan Stanley Capital International Europe, Australia, Far East index declined 11.7%.

Overall, as of Nov. 30, 37 managers interviewed by *Pensions & Investment Age* had $161.3 billion worth of index funds under management. That included $107.4 billion in domestic equities, $43.7 billion in domestic bonds and $5.8 billion in international, almost exclusively equities. The total includes some indexed strategies that are not pure equity or fixed income, such as tactical asset allocation.

Six months earlier, 42 managers surveyed by *P&I Age* had $190 billion in index funds, including $126.3 billion in domestic equities, $43.5 billion in domestic bonds and $6.6 billion in international.

In addition to the index funds run by money managers, there were $65.7 billion worth of index funds run in-house by the nation's top 200 pension funds as of Sept. 30. This is composed of $63.4 billion in stock index funds and $2.3 billion in bond index funds. Nov. 30 figures were not available but, using market performance, *P&I Age* estimates the stock funds would have stood at $52.9 billion and bond funds would have been $2.35 billion. In the two months, the S&P 500 was down 28% and the Shearson Lehman index was up 4.4%.

Indexing has surged in the past few years because of the tendency of active managers to underperform broad market indexes and because of its lower management fees. But some say it's too soon to tell whether the October market plunge will produce another surge.

"Between the 19th (of October) and the end of the year, you're finding pension sponsors re-evaluating what types of strategies they want to be involved with," said Scott Malpass, index fund manager at Irving Trust Co., New York. Many pension executives believe active management does better in down markets and indexing in up ones, but they may not be ready to predict which way the stock market will go, he said.

If pension executives are disappointed by their active managers' year-end results, it's highly likely there will be increased interest in indexing, said Jim Carder, presi-

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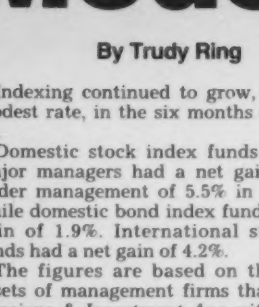
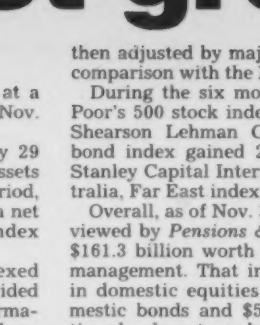
Top index fund managers

($ millions as of 11/30/87)

	Total indexed	Domestic equity	Domestic fixed	International
Wells Fargo Investment Advisors	50,600	35,000	10,500	761
Bankers Trust	23,300	20,250	2,750	250
Mellon Capital Mgmt.	18,043	14,745	2,780	148
State Street Bank & Trust	13,690	8,010	1,980	3,190
American Nat'l Bank[1]	9,550	8,250	1,200	100
Manufacturers Hanover Investment	7,136	236	6,900	0
Mellon Bond Associates	5,900	0	5,900	0
Alliance Capital Mgmt.	4,007	3,707	50	250
Dimensional Fund Advisors	3,057	2,888	0	169
Chase Investors Mgmt.	2,975	1,225	1,400	350
Manufacturers Nat'l Bank of Detroit	2,841	2,811	30	0
Boston Co.	2,225	1,925	150	150
Wilshire Associates	2,200	2,200	0	0
Lehman Mgmt.	2,169	0	2,169	0
T. Rowe Price Associates	2,100	500	1,600	0
Putnam Advisory	1,700	0	1,700	0
Prudential	1,634	588	773	273
Lincoln Capital Mgmt.	1,500	0	1,500	0
The Vanguard Group	957	917	40	0
WR Lazard[2]	903	0	903	0
Northern Trust	892	713	159	20
Harris Trust and Savings Bank	735	435	300	0
Citicorp	640	640	0	0
First RepublicBank Dallas	610	560	50	0
Security Capital Mgmt.	580	0	580	0
Axe Core Investors	505	400	0	105
ASB Capital Mgmt.	379	379	0	0
Centerre Trust	290	290	0	0
First Wisconsin Trust	211	87	124	0
Metropolitan Life	207	207	0	0
Travelers	204	136	15	53
National Bank of Detroit	155	155	0	0
Irving Trust	150	100	50	0
Westridge Capital Mgmt.	100	100	0	0
County Investment	80	0	0	80
Western Asset Mgmt.	78	0	78	0
Seattle First Nat'l Bank	60	0	60	0
TOTAL	161,363	107,454	43,741	5,899

[1] As of 3/1/87. [2] $765 million is managed by consortium of WR Lazard and Smith Barney Harris Upham





Michael Petrino of Matrix Capital, left, says the January effect cannot occur without other economic fundamentals, but William Fouse of Mellon Capital feels reasonably sure the phenomenon will occur.

Timers returning to equity market

By Marlene Givant

Managers implementing market-timing strategies generally have increased their equity exposure since October, but few have done so to benefit from the so-called January effect.

Although managers believe the phenomenon — in which small-capitalization stocks outperform others early in the year — will be borne out, most didn't want to chase the quick uptrend.

"The January effect doesn't show enough times to bet on it in and of itself. You need economic fundamentals to support a rally as well. There has been no January effect in three of the last seven years," said Michael Petrino, president of Matrix Capital Management, Greenwich, Conn.

As for broader strategies, managers interviewed were fairly bullish on stocks. Port-

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Unisys plan unveiled

Merged fund may up alternative investments

By Jacqueline Dutton

BLUE BELL, Pa. — The new Unisys Corp. pension plan, constructed with more flexibility than its predecessors, likely will increase its investments in international, venture capital and real estate.

Unisys' approximately $2.6 billion in employee benefit funds officially will replace those of the former Burroughs Corp. and Sperry Corp. April 1. Unisys is the company formed from the acquisition of Sperry by Burroughs in 1986.

The defined benefit plans' investment policy evolved from the implementation of core decisions: to give the new plan the best features of the old ones; to terminate underperforming or unnecessary managers; and to make the new plan adaptable to strategic changes.

That was the solution arrived at by David White, former Burroughs pension executive and now Unisys vice president of capital management, and his Unisys colleagues, who had the awesome task of consolidating assets of two very differently managed plans into one.

"The program doesn't look like either the Burroughs or the Sperry plan," Mr. White said.

Instead, it has a combination of features, although it more closely resembles the old Burroughs plan in terms of asset allocation and managers. (More than $1 billion of the Sperry plan was in an internally managed balanced account with the now-defunct Sperry Capital Management Co.)

The Unisys plan won't use any balanced managers, but it will, like the Sperry plan, be exposed to international equity and guaranteed investment contracts, and to real estate and venture capital, distinct features of the Burroughs plan.

In fact, international equity likely will compose a greater percentage of total equities in the future. Now, the fund invests roughly $173 million in foreign stocks, an amount carried over from the Sperry plan.

"On our table for '88 is a review of the international sector and its managers," Mr. White said. "We have no cause for concern because they are doing really well," he said.

New strategies, such as currency allocation, also will be considered.

The same consideration will be given for real estate, which was part of the Burroughs plan but not the Sperry plan. Although the current exposure is only 4% of total assets, Mr. White said the target is 15%.

The fund also has displayed a growing interest in the venture capital area; during the fall it hired leveraged buy-out specialist Blackstone Group, a New York Merchant Bank, to invest a $25 million commitment and signing Ventures Trident to invest another $10 million in other ventures, moves which more than doubled total venture capital exposure.

Abbott Capital Management, Wellesley Hills, Mass., which had been a Burroughs' manager, invests $40 million for Unisys in 11 venture capital partnerships. Mr. White said more assets could be moved into venture capital to move total portfolio weighting from the current 2% to the targeted 5%.

Early last summer, Unisys completed its reallocation of the funds managed by Sperry Capital to several managers. Equity manag-

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FINANCING

Underwriting volume dips

By Brad Rudin

NEW YORK — While underwriting volume in 1987 dropped below the bullish levels established in 1986, Salomon Brothers Inc. maintained its lead as the top underwriter in the public domestic market and First Boston/Credit Suisse First Boston continued as No. 1 in the public global market.

Volume figures for most sectors declined, the victim of uncertainty created by the Oct. 19 stock market fall.

In the global market, volume shrank 12% to $432.7 billion from $491.6 billion in 1986, according to Securities Data Co., New York. Domestic volume slid 5.1% to $271.5 billion in 1987 from $286 billion the year before, according to IDD Information Services Inc., New York. The decline is bigger if mortgage-related and agency issues are removed from the domestic total. Calculated this way, the volume of corporate finance underwritings dropped 11.4% to $144.8 billion from $163.4 billion in 1986.

Mortgage-related securities moved against the tide with a 40% increase in underwriting volume.

The mortgage-related market has been helped by investors' "flight to quality" and Wall Street's efforts to educate buyers about the securities, said Chuck Ramsey, a managing director in the mortgage-related unit at Bear, Stearns & Co.

Potential for continued growth exists, Mr. Ramsey said. "If you're talking about what hasn't been securitized, you're talking about trillions out there. It's a marketplace that's immense, gigantic."

The outlook for total volume remains clouded by slow economic growth, a steep yield curve, the quiet Euromarket and the completion of some major financings, said C. William Schroth, a managing director at First Boston. "I think the market as a whole is going to have a tough time equaling 1987 volume in 1988."

That's not good news for Wall Street firms struggling with costs that became part of the budget when the volume of business seemed permanently fixed in a northerly direction.

The volume of common stock financings sank 4.7% to $41 billion from $43 billion in 1986 while the value of high-yield debt offerings fell 10.8% to $28.9 billion in 1987 from $32.4 billion the previous year.

The volume of asset-backed securities increased 3% to $10.3 billion in 1987 from $10 billion the previous year.

For the first time in several years, investment bankers competed in a shrinking market.

"It's been a highly competitive year," said Jason M. Elsas Jr., head of the syndicate department at Salomon. He said ranking No. 1 in domestic underwritings, an honor Salomon has held for five years, has one caveat: "It's a top priority as long as the business is conducted with an eye toward profitability."

Its role as lead manager for such big equity offerings as E-II Holdings Inc. and Carnival Cruise Lines Inc., and bigger debt offerings for the Federal National Mortgage Association and several trusts made Salomon the top-ranked underwriter in the domestic market.

First Boston, with its London-based affiliate, Credit Suisse First Boston, kept its hold on first in worldwide underwritings for the third year running because of the firm's thorough coverage of its clients and involvement in the major sectors of the capital markets, said First Boston's Mr. Schroth.

First Boston made it to the top in worldwide volume with a big debt offering for Allied Stores Corp. and issues backed by mortgages and other assets.

Although Salomon is a powerhouse in the investment-grade debt and mortgage-related debt businesses, the firm ranks below First Boston in the common stock, preferred stock, high-yield debt and asset-backed segments of the market.

The gap between First Boston and Salomon Brothers narrowed in the domestic and global rankings. Salomon held a 14% domestic market share in 1987 compared with the 13.5% share held by First Boston, but in 1986, Salomon took 17.9% of the business vs. First Boston's 15.4%, according to IDD.

1987 underwriting rankings
(Full credit to lead manager)

All issues - global*

Firm	Volume $ mils.	Market share (%)
1. CSFB†	46,316.4	10.7
2. Salomon Brothers	44,733.7	10.3
3. Goldman, Sachs	35,826.4	8.3
4. Merrill Lynch	35,310.5	8.2
5. Morgan Stanley	34,967.6	8.1
6. Drexel Burnham	21,438.4	5.0
7. Shearson Lehman	21,306.3	4.9
8. Nomura	19,388.5	4.5
9. Kidder Peabody	10,578.8	2.4
10. Daiwa	8,752.1	2.0

* all taxable issues, debt and equity, worldwide
† First Boston/Credit Suisse First Boston
Source: Securities Data Co., New York/Euromoney Publications, London

All issues - domestic*

Firm	Volume $ mils.	Market share (%)
1. Salomon Brothers	40,284.5	14.8
2. First Boston	36,628.1	13.5
3. Merrill Lynch	33,420.4	12.3
4. Goldman, Sachs	32,295.8	11.9
5. Morgan Stanley	29,887.0	11.0
6. Drexel Burnham	21,132.7	7.8
7. Shearson Lehman	19,701.2	7.3
8. Kidder, Peabody	10,125.0	3.7
9. Bear Stearns	5,635.8	2.1
10. Prudential-Bache	5,189.0	1.9

* all taxable issues, debt and equity, sold in U.S. only
Source: IDD Information Services, New York

All issues - domestic*

Firm	Volume $ mils.	Market share (%)
1. Salomon Brothers	20,448.1	14.1
2. First Boston	19,864.1	13.7
3. Morgan Stanley	18,615.5	12.8
4. Merrill Lynch	17,048.4	11.8
5. Goldman, Sachs	14,700.6	10.1
6. Drexel Burnham	13,788.7	9.5
7. Shearson Lehman	8,735.1	6.0
8. Kidder, Peabody	3,300.2	2.3
9. Smith Barney	3,168.9	2.2
10. Dillon, Read	2,310.1	1.6

* all taxable issues, debt and equity, excluding mortgage-related and agency issues sold in U.S. only
Source: IDD Information Services, New York

Non-convertible debt issues

Firm	Volume $ mils.	Market share (%)
1. Salomon Brothers	36,830.7	17.6
2. First Boston	31,802.6	15.2
3. Merrill Lynch	27,255.9	13.0
4. Morgan Stanley	24,805.5	11.9
5. Goldman, Sachs	23,045.3	11.0
6. Drexel Burnham	16,618.7	7.9
7. Shearson Lehman	15,515.2	7.4
8. Kidder, Peabody	7,485.2	3.6
9. Bear, Stearns	4,635.3	2.2
10. Prudential-Bache	4,013.7	1.9

Source: IDD Information Services, New York

Non-investment grade debt

Firm	Volume $ mils.	Market share (%)
1. Drexel Burnham	11,622.9	40.3
2. Morgan Stanley	4,353.4	15.1
3. First Boston	4,039.8	14.0
4. Merrill Lynch	3,345.4	11.6
5. Goldman, Sachs	1,975.0	6.8
6. Salomon Brothers	1,153.1	4.0
7. Kidder, Peabody	503.9	1.7
8. Donaldson Lufkin	492.7	1.7
9. Dean Witter	321.5	1.1
10. Shearson Lehman	257.0	0.9

Source: IDD Information Services, New York

Convertible debt

Firm	Volume $ mils.	Market share (%)
1. Smith Barney	1,700	17.4
2. Drexel Burnham	1,170	12.0
3. Goldman, Sachs	1,035	10.6
4. Morgan Stanley	960	9.8
5. First Boston	810	8.3
6. Shearson Lehman	495	5.1
7. Lazard Freres	465	4.8
7. Alex. Brown	465	4.8
9. Kidder, Peabody	457	4.7
10. Salomon Brothers	435	4.5

Source: IDD Information Services, New York

Mortgage-related debt

Firm	Volume $ mils.	Market share (%)
1. Salomon Brothers	16,016.2	19.8
2. First Boston	11,992.9	14.8
3. Merrill Lynch	9,126.7	11.3
4. Goldman, Sachs	8,262.7	10.2
5. Morgan Stanley	6,282.3	7.8
6. Shearson Lehman	5,942.4	7.3
7. Kidder, Peabody	4,442.0	5.5
8. Drexel Burnham	4,000.0	4.9
9. Bear Stearns	3,540.0	4.4
10. Prudential-Bache	2,442.2	3.0

Source: IDD Information Services, New York

Common stock

Firm	Volume $ mils.	Market share (%)
1. Goldman, Sachs	6,652.6	16.2
2. Merrill Lynch	4,458.3	10.9
3. Alex. Brown	2,733.7	6.7
4. Shearson Lehman	2,623.1	6.4
5. First Boston	2,551.7	6.2
6. Wheat, First	2,535.0	6.2
7. Drexel Burnham	2,481.1	6.0
8. Morgan Stanley	2,254.1	5.5
9. Salomon Brothers	2,108.7	5.1
10. Kidder, Peabody	1,350.3	3.3

Source: IDD Information Services, New York

Non-convertible preferred stock

Firm	Volume $ mils.	Market share (%)
1. Goldman, Sachs	1,373	17.4
2. First Boston	1,173	14.9
3. Merrill Lynch	1,145	14.5
4. Morgan Stanley	1,142.4	14.5
5. Salomon Brothers	910	11.5
6. Drexel Burnham	660	8.4
7. Shearson Lehman	511.1	6.5
8. Bear Stearns	280	3.5
9. Oppenheimer	270	3.4
10. Kidder Peabody	165	2.1

Source: IDD Information Services, New York

In the global ranking, prepared by Securities Data, First Boston/Credit Suisse First Boston held a 10.7% market share in 1987 compared with the 10.3% share held by Salomon. In 1986, First Boston/CSFB did 13.2% of the business vs. Salomon's 12%.

Wall Street's top five firms held a combined domestic market share of 63% in 1987 compared with 65% in 1986. Worldwide, the top five held 46% of the market share compared to 48% the previous year.

Overall, the lineup of managers in the top spots changed considerably between 1986 and 1987. In the domestic market, Morgan Stanley & Co. Inc. dropped to fifth place after placing third in 1986, and Drexel Burnham Lambert Inc. fell to sixth place from fourth a year earlier.

Merrill Lynch muscled its way to third after finishing fifth in 1986, and Goldman, Sachs & Co. boosted its standing by moving to fourth place from sixth.

In the global ranking, third-ranked Goldman, Sachs switched places with Morgan Stanley, which finished 1987 in fifth place.

The year's most notable come-from-behind story is probably the performance of Smith Barney, Harris Upham & Co. in the convertible debt market. Smith Barney, which ranked 12th in that market in 1986, displaced Drexel Burnham Lambert Inc. for the top spot last year.

"We recognized the potential demand for new convertible offerings," said A. Richard Janiak, managing director at Smith Barney. "We informed our clients of that early."

Smith Barney managed big convertible debt offerings for Prime Computer Inc., Browning-Ferris Industries Inc., The Mead Corp. and other issuers.

Morgan Stanley came from near the cellar in the convertible preferred stock sector, moving to the top spot from 13th in 1986. Drexel was the first-ranked underwriter in this sector in 1986.

The leaders in various domestic market segments generally held their top-ranked positions, but the gap between No. 1 and the runner-up typically diminished.

For example, First Boston saw its 90% share of the asset-backed security market drop to 50% in 1987. IDD includes debt and equity issues backed by non-mortgage commercial receivables.

First Boston's decline in market share was not unexpected, Mr. Schroth said, noting Wall Street firms typically adapt ideas developed by others. "New products in investment banking have a very short half-life. If you can figure out a way we can copyright new ideas, that would change the business dramatically."

Similarly, Drexel saw its share of the public high-yield debt market shrink to 40% after holding 45% in 1986. "Market share is not as important as other things," said a Drexel spokesman, adding the firm's private placement of high-yield offerings boosts its share of the total high-yield market.

Morgan Stanley chopped away at Drexel's lead in 1987 with big high-yield financings for Owens-Illinois Inc., Burlington Holdings Inc. and other issuers. Morgan has boosted its professional high-yield staff by between 30% and 40% since 1986, said Neal S. Garonzik, a managing director in the merchant banking department. ■

CURRENT ACCOUNTS

Continued from page 30

JMB Realty Corp.
Sacramento (Calif.) County Employees' Retirement System: private placement; $30 million. Pension Reserves Investment Trust Fund: private placement; $15 million. California State Employees' Retirement System: private placement; undetermined. American Information Technologies Corp.: private placement; undetermined. State of Connecticut Trust Funds: private placement; undetermined. Iowa Public Employees Retirement System: private placement; undetermined. Board of Pensions of the Presbyterian Church: private placement; $30 million.

Murray Johnstone Ltd.
Shipbuilding Industries Pension Scheme: equities; $139.7 million.

Johnstown Bank and Trust Co.
Lee Hospital: fixed income; $3.15 million.

W.R. Lazard & Co.
Avon Products Inc.: fixed income; $18 million.

Lazard Freres Asset Mgmt.
Morton Plant Hospital Retirement Fund: equity; $5 million.

Lehndorff & Babson Real Estate
School Employees Retirement System of Ohio: real estate management; $155 million.

Liberty Capital Mgmt. Inc.
Easco Corp: fixed income; $7.5 million. Fel-Pro Inc.: fixed income; $5 million.

Lincoln Capital Mgmt. Co.
Allegis Corp.: equities; undetermined.

Loomis, Sayles & Co.
Tucson Electric Power Co.: active fixed income; $8.3 million. Ray Industries: fixed income; undetermined. League of Voluntary Hospitals and Homes of New York: corporate fixed income; undetermined.

Manning and Napier Advisors
Cyclops Corp.: balanced; $10 million.

McCowan Associates Inc.
Allegis Corp.: equities; undetermined.

Mechanics Bank
California Bankers Association: balanced; $13 million.

Mellon Capital Mgmt. Corp.
Bayer USA Inc.: S&P index fund; $31 million.

Metropolitan Life Insurance Co.
Citicorp: annuities; $400 million. Fulton County (Ga.) pensions funds: guaranteed real estate contract; $1.5 million.

Miller, Anderson and Sherrerd
Moore Corp. Ltd.: equity; $70 million. Columbia University endowment: fixed income; $75 million. Columbia University endowment: equity; $150 million. Pennsylvania State Employes' Retirement System: equity; $100 million. Iowa Electric Light & Power Co.: equities; $100 million.

Morgan Grenfell Investment Services
Los Angeles County Retirement Fund: international equity; $90 million.

J.P. Morgan Investment Mgmt.
League of Voluntary Hospitals and Homes of New York: open-end real estate fund; undetermined. Missouri Local Government Employees' System: open-end real estate fund; portion of $15.5 million. Allegis Corp.: fixed income; undetermined. Hercules Inc.: dedicated bond account; $100 million.

NCNB National Bank
Jacksonville (Fla.) Police and Fire Pension Fund: real estate; $15 million.

Neuberger & Berman
Lee Hospital: fixed income; $3.15 million.

Newbold's Asset Mgmt.
Jefferson County (Ala.) General Retirement System: equity; about $20 million.

Nikko & Associates Inc.
Thomas J. Lipton Inc.: indexed equity; $120 million.

NWQ Investment Mgmt. Co.
City of Aurora (Colo.) Retirement Plan: balanced; $15.5 million.

Pacific Investment Mgmt. Co.
Allegis Corp.: fixed income; undetermined.

L. Roy Papp & Associates
City of Aurora (Colo.) Retirement Plan: balanced; $10 million.

PRIMCO Capital Mgmt. Inc.
Ray Industries: fixed income; undetermined.

Provident Investment Counsel
Pennsylvania State Employes' Retirement System: equity; $100 million. Iowa Electric Light & Power Co.: equities; $100 million.

Prudential Insurance Co.
General Motors Corp.: manager of GM convertible preference shares; $1.04 billion.

Rosenberg Institutional Equity
Columbia University endowment: equity; $150 million.

Salomon Brothers Inc.
Maryland State Retirement and Pension Systems: dedicated bond portfolio; $4 billion.

Sasco Capital Inc.
League of Voluntary Hospitals and Homes of New York: equities; undetermined.

SBC Portfolio Mgmt. Int'l Inc.
Whirlpool Corp.: international equity; $35 million. Upjohn Co.: international equities; $24 million.

Schroder Capital Mgmt. Int'l
Whirlpool Corp.: international equity; $35 million. Upjohn Co.: international equities; $24 million.

Schroder Real Estate Associates
Alameda County (Calif.) Employees' Retirement Assn.: closed-end real estate fund; $7.5 million.

Securities Counsel Inc.
Herman Miller Inc.: equity; $5 million. Houston Municipal Employees Retirement System: equity; $19 million. LSI Lighting Systems Inc.: balanced; $2 million. American Trans Air Inc.: undetermined; $1.5 million.

Sit Investment Associates Inc.
Allegis Corp.: equities; undetermined.

State Street Bank & Trust Co.
Tucson Electric Power Co.: master trustee; $37 million. International City Management Association Retirement Corp.: master trustee; $850 million. Gulf & Western Inc.: GIC portfolio; $150 million. Campbell Soup Co.: GIC fund; undetermined. Inland Steel Industries Inc.: guaranteed investment contract fund; $65 million.

STW Fixed Income Mgmt. Inc.
Columbia University endowment: fixed income: $50 million. Ray Industries: fixed income; undetermined. Fel-Pro Inc.: fixed income; $20 million.

Sun Banks Inc.
Alexander & Alexander Inc.: equity; $20 million. Pennsylvania State Employes' Retirement System: equity; $200 million.

Sun Bank Investment Mgmt. Group
Easco Corp.: equities; $4.6 million. Iowa Electric Light & Power Co.: equities; $30 million. Pennsylvania State Employes' Retirement System: equities, $200 million. Jacksonville (Fla.) Police and Fire Pension Fund: equities; $30 million.

Sun Bank Trust Banking Group
Morton Plant Hospital Retirement Fund: equity; $5 million.

TCW Realty Advisors
Missouri Local Government Employees' System: closed-end real estate fund; portion of $15.5 million.

Thompson, Siegel & Walmsley
Jefferson County (Ala.) General Retirement System: equity; about $20 million.

Warburg Investment Mgmt. Int'l
Los Angeles County Retirement Fund: international equity; $90 million.

Weiss, Peck & Greer
Columbia University endowment: fixed income; $25 million. Allegis Corp.: equities; undetermined.

Western Asset Mgmt. Co.
Batus Inc.: fixed income; $50 million to $100 million.

Indexing

Continued from page 3

dent of Westridge Capital Management, Los Angeles.

On Oct. 19 and the next few days, some users of The Vanguard Group's actively managed stock mutual funds expressed interest in moving to the index funds, as some of the active funds had higher volatility than the market, said Brian Mattes, vice president of Vanguard, Valley Forge, Pa.

Stock index arbitrage — moving between stock index funds and futures to take advantage of mispricings — has been accused of causing or exaggerating the stock market's decline. With that has come the threat of new regulation of such trades, but several stock index fund managers continue to use arbitrage.

Any new regulations would affect everyone, Mr. Fouse noted. "Worry (about new regulations) is non-productive," he said.

"Regulations may not be as pointed as it seemed they would be in the third week in October," Mr. Krisik added.

A few have pulled back from arbitrage. "Clients perceive that as being very risky," Mr. Malpass said, so Irving Trust hasn't used the strategy much since October.

Vanguard, like some other managers, has never used arbitrage in its index funds. "The use of futures and options for other than hedging purposes actually puts on more risk than the market itself has," Mr. Mattes said.

Those that are using arbitrage report it still offers plenty of opportunities to add return. "We've had no shortage," Mr. Carder said.

The use of futures and options to enhance bond index funds is becoming more widespread. Security Capital Management Inc., Stamford, Conn., maintains a heavy position in interest rate futures, said Bob Brewer, chief investment officer.

Overall, bond indexing is gaining increased acceptance, managers said. "We have seen an increase in interest in structured fixed-income management, to include indexing," said Ken Meyer, executive vice president of Lincoln Capital Management, Chicago.

Bond index funds may benefit especially if pension funds increase bond allocations in response to Black Monday, said Ed Swan, manager of the asset management group at WR Lazard & Co., New York.

Index fund managers track a wide variety of benchmarks; among stock index funds, the S&P 500 remains the index of choice, but new and customized indexes are picking up ground.

Not all managers provided data on how much of their assets tracked a given index. Among stock index fund managers that did — accounting for $70.4 billion, $45.1 billion, or 64.1%, tracked the S&P 500 or a subset of it as of Nov. 30.

The Wilshire 5000 accounted for $3.8 billion, or 5.4% of the assets, and various other indexes accounted for $21.4 billion, or 30.5%. Most of the $21.4 billion tracks indexes customized for clients, but a modest portion is tied to the Russell 1000, 2,000 or 3,000 indexes.

Among the $36 billion in bond index funds for which this information was available, $19.9 billion, or 55.3%, tracked custom indexes. A total of $12.5 billion, or 34.7%, tracked the Shearson Lehman index or a subset of it and $3.6 billion, or 10%, tracked the Salomon Brothers Broad Investment Grade bond index or a subset of it.

Among the $5.5 billion in international funds for which the information was available, $3.8 billion, or 69%, tracked the Morgan Stanley Capital International EAFE or World indexes, while the remainder tracked various new or customized indexes. ■

Active managers don't beat market

By Jacqueline Dutton

SANTA MONICA, Calif. — Active equity managers underperformed the stock market in October and the 10 months ended Oct. 31, and value managers failed to add much value in the down market, according to unpublished data compiled by Wilshire Associates for its clients.

Marcia Ryles, senior associate at Wilshire, said the performance of 113 active managers — those who sell themselves on their ability to outperform the market on a risk-adjusted basis — was worse overall than the Standard & Poor's 500 stock index for the one- and 10-month periods.

"There was a wide range of returns, but it shows most managers did not add value to the index," she said.

In addition, Ms. Ryles said value managers — who typically are the better performers in down markets — added little value over the S&P 500 for the month of October.

"They offered very little protection," she said. Because they failed to add real value to portfolios, she suggested the "value" managers might be more appropriately described as "conservative" managers.

Ms. Ryles said the performance figures have raised the eyebrows of Wilshire clients, but have not resulted in any terminations. She said instead of pointing the finger at individual managers, pension fund executives are stepping back and reassessing their asset allocations, which likely will result in a transfer of assets into indexed accounts.

"Our clients right now are mostly taking a wait-and-see approach," she said, but that could change as a result of year-end evaluations, she added.

She said clients also are interested in looking more at asset structure than manager selection because those who were well diversified heading into the October crash were glad of it.

"Most of our clients are taking a look at asset allocation because this showed it (diversification) really worked," Ms. Ryles said.

The median performance among active managers profiled by Wilshire was −22.4% during October, while the S&P index returned −21.6%. Managers in the fifth percentile returned at least −15.2% and those in the top 25% returned at least −19.5%. Managers in the 75th percentile range returned −25.3% at the minimum, and those in the 95th percentile bettered −29.6%.

Active managers fared even more miserably during the 10 months. Ms. Ryles said the median manager in the Wilshire universe returned only 1.6%, while the S&P 500 returned 6.6%, a figure that would have placed the index at the 20th percentile in the universe. The top quartile of managers returned at least 5.7% and the top 5% of managers returned a minimum 11.6%. Those in the 75th percentile returned at least −2.5% and those in the 95th percentile returned a minimum −8.5%.

When the performance of the 20 managers in the universe that use value-oriented styles were broken out, the results were even more surprising, she said.

The median manager, Ms. Ryles said, barely outperformed the market during October, with a −20.8% return, adding less than one percentage point of value. In contrast, Ms. Ryles said, value managers added up to five percentage points of value during the down market in 1981.

"It seems they added more value in that previous down period, but perhaps it was a different market," she said. "(And) no one added value in this market."

The best-performing value managers, she said, probably held a lot of cash. The top fifth percentile returned at least −16.1% in October and the top quartile, −18.9%. The third quartile returned at least −22.6% and the 95th percentile returned at least −25.4%.

For the 10-month period, value managers also failed to beat the market; the median managers returned 2.9%.

401(k) view changing

WASHINGTON — Bruised by tax reform and battered by the stock market crash, investors who used 401(k) plans to pick up short-term gains in stocks might change their ways, according to the the Employee Benefit Research Institute.

According to the non-profit public policy research organization, tax reform left 401(k)s more attractive as long-term retirement plans, particularly as an alternative to individual retirement accounts.

Tax changes put a $7,000 limit on tax-exempt contributions to 401(k) plans and placed restrictions on early withdrawals, EBRI stated.

The market crash showed those who chose to invest contributions only in stocks the risks behind putting all the nest eggs in one basket.

EBRI predicted there will be more diversification into other investment options, such as bond funds, as a result of the crash.

The value of defined contribution plans — typically tax-sheltered savings plans in which employees contribute part of their pay — dropped $54 billion, or 12%, from the market's peak Aug. 25 to Oct. 30.

But these changes will affect a minority of 401(k) plan investors, typically those at the high end of the pay scale.

Still, EBRI suggests employers should make an effort to help employees understand the risks and the rules associated with plan participation. ■

Financing

Continued from page 1
ties of their bond offerings and increase their dependence on bank borrowing. The flight to quality precipitated by the recent collapse in stock prices will keep issuance of high-yield debt in 1988 below the near $3 billion average monthly clip of 1987. In response to a declining dollar, and the attendant lack of interest by investors abroad, U.S. corporations will curtail their bond offerings in the Eurodollar market.

The projected steady level of net bond financing in 1988 masks continued declines in gross offerings and call activity, the investment bank said. Gross issuance will come to $126 billion, $5 billion less than this year and $20 billion below 1986's level. Calls, which totaled nearly $40 billion in 1986 and about $32 billion in 1987, will amount to just $27 billion next year.

Both trends, Salomon Brothers said, reflect a significant drop-off in utility refinancings.

Meantime, equity retirements will overwhelm new issuance for the fifth consecutive year. The volume of new cash offerings will fall by about $10 billion, or 15%, and retirements via buybacks will increase modestly, the investment bank predicts.

On the pension side, the investment bank said that during October, the average funding ratio for corporate pension sponsors slipped to 160% from about 200%. Any favorable earnings impact that had been anticipated in the form of reduced pension expenses has been muted.

Nonetheless, the surplus still stands somewhat above year-end 1986 levels.

The impact of the decline in the pension surplus on balance sheets might be more significant. Under the Financial Accounting Standards Board Statement 87, if pension assets fall below liabilities, the shortfall must be carried on the balance sheet as a net unfunded liability. In September, only 2% to 3% of all pension sponsors had a net unfunded pension liability. After Oct. 19, 5% to 10% of all pension sponsors fell into that category.

Salomon Brothers said it is reasonable to assume pension sponsors that have a small surplus, with assets only slightly in excess of liabilities, will be loath to report a new liability on the balance sheets. These pension sponsors will have a powerful incentive to avoid equity market risk and could well be active sellers of stocks in 1988.

Salomon expects both public and private pension funds to shift from equity investment toward debt instruments of appropriate duration.

Private funds are expected to accelerate their net liquidation of stocks to more than $30 billion in 1988 from about $19 billion in 1987.

More specifically, Salomon said that for the first time in the post-World War II period, financial institutions will be net sellers of corporate stocks — liquidating more than $10 billion in 1988. In 1986 they acquired nearly $50 billion, and in 1987, Salomon estimates they took down more than $10 billion.

The selloff is concentrated in private pension funds, which continue their shift out of equities into long-duration debt. Even after the market collapse, pension funds have nearly $525 billion, or 55% of their total assets, in stocks. Other institutions will either be net sellers or will curtail their net equity purchases substantially in the wake of 1987's extreme market volatility, the Salomon report said.

Turning to another financing trend, Salomon Brothers said it expects the booming market for mortgage-backed securities to slow amid weak residential housing starts and new residential mortgages and excess capacity in commercial mortgages.

Net additions to the supply of securitized mortgages will remain at the slow pace of the last few months of 1987. This will translate into an annual volume of $122 million, $20 billion below 1987's level. ■

Net equity purchases / 1982 through first half of 1987
($ millions)

	First half 1987	1986	1985	1984	1983	1982
Foreign investors	27.7%	31.2%	11.8%	—	11.7%	11.9%
State and local pension funds	28.7	22.1	49.5	52.6%	43.0	18.3
Mutual funds	34.1	35.0	24.6	42.3	29.3	10.6
Property/casualty insurance	4.3	4.7	—	—	4.5	8.2
Life insurance	4.9	6.8	14.1	5.1	6.5	10.4
Private pension funds	—	—	—	—	4.9	40.6
TOTAL NET BUYING	$63,975	$57,430	$42,004	$13,838	$46,507	$32,908

Source: Salomon Brothers Inc., New York

Foreigners jump in

Overseas cash pumped up soaring market

By Joel Chernoff

NEW YORK — Foreign investment in U.S. equities buoyed the stock market through the first three quarters of 1987, a Salomon Brothers Inc. study shows.

The study found 76.7% of the Dow Jones industrial average's 800-point gain in the nine-month period occurred during the first half-hour of each trading day, when overseas buyers are most active. "Similarly, 83.5% of the total net inflow of $23.3 billion occurred in the same 30-minute span" of the trading day, said Salomon's market review and outlook for global equities.

But when the surge of foreign buying will return (after being stopped short by the Oct. 19 stock market crash) remains uncertain, as central banks attempt to stabilize the falling dollar. Until that time, "a (foreign) customer would be somewhere between heroic and stupid" to invest in the U.S. market, said Robert Brusca, senior vice president and chief economist for Nikko Securities Co. International, New York.

"I think you'd need a long period of stability to get foreigners interested in size," said George Murnaghan, vice president at Rowe-Price Fleming International Inc., Baltimore.

Without a stabilized dollar, pressure to push up the stock market will have to come from U.S. investors, he said. But a dried-up flow of foreign dollars has negative implications for the bond market, which may see higher yields to attract investment. That, in turn, is bad news for the stock market, Mr. Murnaghan said.

Some investment professionals already see signs that foreign investors are renewing their plans to plunge into U.S. stocks.

The Japanese tend to stick with their long-term objectives and now, with stocks at cheaper prices and the dollar devalued, "it's like Filene's basement — name-brand products for 20% off," said William Jacques, partner at Martingale Asset Management, Boston.

Last week, with the dollar showing signs of recovering from post-World War II lows against the Japanese yen, Japanese investors started to edge back into the U.S. stock market, said Motoi Okada, executive vice president, Daiwa Securities America Inc., New York.

But Japanese investors are ready to flee if the market declines, Mr. Okada added.

Market observers have suggested foreign investors have boosted stock prices during the past couple of years. In particular, prices of stocks in the Standard & Poor's 500 index have increased far more than stocks of similar capitalization, reflecting foreign desires to purchase household names as well as the effect of growing assets placed in index funds and use of derivative instruments (*Pensions & Investment Age*, Sept. 7).

The Salomon Brothers study provides some hard evidence to back the contentions: Foreign investors accounted for 27.7% of net equity purchases in the first half of 1987, 31.2% in 1986 and 11.8% in 1985.

Only state and local pension funds and mutual funds have played as large a role in making net equity purchases during that time, while net purchases by private pension funds have been flat since 1983 (*see chart*).

In fact, private funds experienced net withdrawals in 1987, according to the Employee Benefit Research Institute, Washington. Private pension funds had net withdrawals of $13.1 billion from stocks in the third quarter, a sharp increase from the second quarter's $4.8 billion withdrawal, and close to the $15.7 billion in withdrawals in the first quarter of 1987.

In addition, Salomon expects households to be net sellers to mutual funds, public funds and foreign investors.

The Salomon study also found:

- Euroequity issues soared to $21 billion in 1987, up from $600 million in 1983. U.S. corporations relied more on global issues, with Eurotranches accounting for 8.7% of total issuance, up from 5.2% in 1986.
- Mergers and acquisitions have become increasingly global. Nearly one-third of the $281.4 billion in mergers and acquisitions worldwide were transnational, including such major deals as British Petroleum's $7.4 billion acquisition of Standard Oil Co., Cleveland, and Chicago-based Amoco Corp.'s $4.1 billion purchase of Dome Petroleum Ltd., Calgary, Alberta.
- Corporate reorganizations continued strong in 1987, with total completed and pending efforts reaching $231 billion, down from $275 billion in 1986. Of that total, corporate buyback programs surged to $70.8 billion from $44.8 billion the year before; one-third of the announced share buybacks occurred in the second half of October.
- The 10 S&P 500 stocks whose market capitalizations appreciated the most accounted for 37% of the index's gains, led by **Merck & Co. Inc.**, **Dow Chemical Co.** and **Ford Motor Co**.
- The 10 stocks whose prices showed the largest gains however, added just 6.5% of the gain to a market-weighted portfolio. The biggest gainers were **Reynolds Metals Co.**, 107.5%; **Bethlehem Steel Corp.**, 106%; **Phelps Dodge Corp.**, 92.7%; and **First Mississippi Corp.**, 92%.
- 1988 will be a difficult year for the stock market. The presidential elections, the possibility of a recession, changes in the securities industry — including a decline in research and an unclear future for derivative instruments — and memories of the October crash make predictions uncertain. Nevertheless, Salomon suggests that aerospace, oils, insurance and banking-industry stocks could do well.
- Worldwide markets will perform well, influenced by positive growth rates, stable governments, growth of derivative securities trading and other factors, such as liberalized capital markets, growth in international funds, adequate global liquidity, continued privatizations of government-owned companies, and increased debt-for-equity swaps in developing markets. ■

Fund makeover

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billion, were not affected.

The six passively managed core portfolios, which initially will hold between $6.4 billion and $8 billion, represent growth- and value-oriented accounts in each of three capitalization groups — large, intermediate and small — and will hold about 1,000 different stocks.

The original parameters for the capitalization groups were $1 billion or more in market capitalization for the large group, $500 million to $1 billion capitalization for the intermediate group and $500 million or less for the small group.

"We float (the parameters) with changes in the market so that we get a uniform group of companies" in each of the categories, Ms. Marshall said.

Computer models then are used to screen out stocks from these broad groups for the active portfolios, to which between $1.6 billion and $2 billion will be allocated initially.

"Depending on the results we get, we'll either increase or decrease the allocations to the active portfolios," she said.

The active portfolios were created because "we wanted to see if we could add value" through active management, she said. The performance of the active portfolios, as well as that of the external managers, will be compared to the results of the core portfolios.

"We'll be comparing to the normal indexes also, but I felt we'd have more meaningful information if we had these very specifically designed subsets.

"We thought we could make better decisions regarding the capabilities of our managers if we had better portfolios to compare them against," Ms. Marshall said. Results of the outside actively managed portfolios also will be compared to the results of the in-house active portfolios.

"The capitalization sizes are important because there has been reason to believe in the past that small-cap stocks outperform (large-cap stocks) over a long period of time."

In addition, "we wanted to find out if there is more value from active management in the (large-capitalization) sector or the small sector," she said.

Ms. Marshall said the retirement system has about $2 billion invested in about 100 different stocks of companies doing business in South Africa. Those holdings are being placed in a separate portfolio because California law requires the system to sell all such holdings during the next three years. ■

Market swings

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but showing up on 44% of the ballots.

Last year, two federal appeals courts issued rulings on the question of surplus asset ownership, yet the decisions did little to resolve the dispute.

In a case heard by the 11th U.S. Circuit Court of Appeals, Blessitt vs. Dixie Engine Co., the employer was ordered to pay out unaccrued, forfeitable benefits as well as all accrued benefits before taking any of the surplus assets. In the other case, Tilley vs. The Mead Corp., heard in the 4th U.S. Circuit Court of Appeals, the employer was ordered to pay out early retirement benefits to compensate employees who had not reached the designated retirement age.

For the second year in a row, portfolio insurance made enough headlines to rank among the five most important stories, squeaking into the top five with only 29 points but appearing on more than 40% of the questionnaires.

The strategy was in the news throughout the year, but never more so than following the Oct. 19 market crash. Already being questioned for its higher-than-expected costs, the program was in the spotlight after the crash as pension and other investment industry executives tried to decide whether the strategy was a success and what — if any — role it played in pushing the falling market down even further. ■